**CPUC RULEMAKING 17-07-007**

**Working Group Issue #7**

**January 23, 2018**

**Draft for Discussion Purposes Only**

**Request:**

Provide historical information on realized tax liability associated with Rule 21 export projects that were given a safe harbor designation to the ITCC charge, losing that safe harbor, and the IOU being required to pay the associated taxes?

**SCE Response:**

Tax authorities have not, as of the date of this response, audited and assessed a tax liability associated with SCE’s 61 Rule 21 projects[[1]](#footnote-1) in which generators attested to satisfying the initial Internal Revenue Service safe harbor provisions to be excluded from SCE’s taxable income. SCE relies on the generator’s contractual representation that 1) in light of all the information available at the time the intertie is contributed, it is reasonably projected that, during the ten taxable years beginning when the intertie is placed in service, no more than 5% of the projected total power flows over the intertie will flow to the generator,[[2]](#footnote-2) 2) ownership of the electricity wheeled over SCE’s transmission system remains with the generator prior to its transmission onto the grid,[[3]](#footnote-3) 3) the intertie will be used for transmitting electricity,[[4]](#footnote-4) and 4) the cost of the intertie is capitalized by the generator as an intangible asset and recovered using the straight-line method over a useful life that is treated as 20 years.[[5]](#footnote-5) If any one of these representations made by a generator are inaccurate, the entire contribution will be taxable to SCE in the year it was placed in service. SCE relies on the generator’s representations and does not independently audit these representations. As such, SCE cannot independently stipulate that these 61 Rule 21 interconnection are not taxable without performing initial audits on each of these transactions when they were placed in service. The Internal Revenue Service can decide to audit SCE’s 61 Rule 21 interconnections to verify their nontaxable treatment in the year they were placed in service.

In addition, the tax audit risk exposure does not end for SCE in the year the intertie is placed in service. An initial nontaxable interconnection transaction under the IRS safe harbor provisions can become taxable to SCE in any future tax year if any of the following events occur. Proportionate Disqualification – If, for each of any three taxable years within any period of five consecutive taxable years, more than 5% of the total power flows over the intertie flow from the utility to the generator, then the generator will be deemed to have made a transfer to the utility that constitutes a taxable contribution in aid of construction pursuant to Internal Revenue Code Section 118(b).[[6]](#footnote-6) Termination of Power Purchase Contract – Upon the termination of a power purchase contract between a generator and a utility, if the utility obtains or retains ownership of the intertie, the generator will be deemed to have made a taxable contribution to the utility if circumstances indicate an intention by the parties to characterize a contribution of the intertie as a transaction that in substance constitutes a taxable contribution.[[7]](#footnote-7) The Internal Revenue Service can decide to audit SCE’s 61 Rule 21 interconnections in any subsequent tax years to verify whether they should continue to be treated as nontaxable to SCE.

The 61 Rule 21 projects over the past ten years in which generators attested to satisfying the initial Internal Revenue Service safe harbor provisions to be excluded from SCE’s taxable income represent a total nontaxable contribution amount of approximately $15.0 million with a related total ITCC security amount of approximately $2.4 million. Should an interconnection customer be unable to make the indemnification payment, the utility would be exposed to a loss since the facility cost responsibility is directly assigned to the interconnection customer and the utility is not able to recover these costs from other customers. Accordingly, the collection of a security instrument that covers the cost consequence of the tax liability is appropriate.

1. A ten year period was utilized for purposes of this response. [↑](#footnote-ref-1)
2. Section III.C.1.a. of IRS Notice 2016-36 [↑](#footnote-ref-2)
3. Section III.C.2. of IRS Notice 2016-36 [↑](#footnote-ref-3)
4. Section III.C.4. of IRS Notice 2016-36 [↑](#footnote-ref-4)
5. Section III.C.5. of IRS Notice 2016-36 [↑](#footnote-ref-5)
6. Section IV.A. of IRS Notice 2016-36 [↑](#footnote-ref-6)
7. Section IV.B. of IRS Notice 2016-36 [↑](#footnote-ref-7)